



186 Riverside Drive
New York, NY 10024
PHONE 212 874 2947
FAX 212 595 1492
EMAIL andrea@akfconsulting.com

MEMORANDUM

TO: BOARD OF TRUSTEES, ALABAMA COLLEGE COUNTS 529 FUND
FROM: AKF CONSULTING GROUP
DATE: JULY 30, 2012
RE: OVERVIEW OF 529 FEDERALLY-INSURED PRODUCTS

I OVERVIEW

Since December 2005, the college savings market has witnessed a substantial increase in the number of federally-insured products offered in 529 plans. Prior to that date, the benefits of Federal Deposit Insurance Corporation (“FDIC”) or National Credit Union Administration (“NCUA”) guarantees were limited to 529 “trusts”, without extension to individual 529 investors. As a result, only the 529 Plans in Arizona and Montana offered insured bank products and in each case, the Plan was managed by the College Savings Bank, a New Jersey-chartered savings bank.¹

The landscape changed as of December 2005, however, when the FDIC and NCUA extended the benefit of federal insurance to individual 529 plan investors.² Today, twenty 529 Plans across seventeen States offer thirty one distinct federally-insured choices. Five 529 Plans are comprised entirely of bank products offered by one bank (which we refer to these as “stand-alone 529 bank plans”), while fifteen 529 Plans offer bank products as investment options within a broad array of 529 investment options (we refer to these as “individual investment options”). No State has yet offered a multiple-bank product per se although the model remains one that is often considered, particularly by various state banking associations across the country.³

This memorandum presents an overview of federally-insured products, including a summary of the regulatory and legislative framework and a snapshot of products in the market today. It concludes with several considerations and possible next steps for the Alabama CollegeCounts 529 Fund Board.

¹ Hawaii, Illinois and Maine incorporated certificates of deposit prior to 2005 but the FDIC insurance extended only to the trusts, not to the actual investors. Both Hawaii and Illinois eliminated the bank components upon conversion to new program managers in 2007. It appears that Maine has replaced the right to invest cash in Maine-bank certificates of deposit with the Bank of America Savings Portfolio. In about 2007, the State of Oregon offered an equity-linked bank-insured product through Oppenheimer Funds. The product was offered as an individual investment option but only through the advisor channel. It is no longer available.

² The FDIC and NCUA have similar \$250,000 insurance coverage. Today, only North Carolina offers an NCUA-backed investment option directly to investors. For the remainder of this memo, we refer only to the “FDIC” but implicitly this includes the NCUA.

³ Missouri tried unsuccessfully to implement a bank plan that would include bank products from multiple in-State banks. The Missouri Bankers Association even submitted a request for a No-Action Letter from the Securities and Exchange Commission, which the SEC summarily dismissed. See **SECTION II, LEGISLATIVE AND REGULATORY MATTERS**. Wisconsin ultimately structured its multiple-bank product as a single investment option with the federal insurance extending only to the Wisconsin Trust and not to individual investors. See **SECTION IV, OBSERVATIONS ON MODELS, MULTIPLE BANK OPTIONS** in this memo.



II REGULATORY AND LEGISLATIVE MATTERS

The FDIC provides insurance for up to \$250,000 in deposits in similarly titled accounts at the same FDIC-insured banking institution. This means that if a bank fails, all the accounts in one customer's name are aggregated for purposes of the \$250,000 guarantee. Prior to the FDIC's 529 rule change in 2005, the FDIC viewed the 529 trust itself as the "customer" or "owner" of underlying investments in insured products. As a result, the maximum FDIC insurance coverage (then \$100,000 per customer) was applied to the entire 529 plan. With the FDIC coverage extending to each participant in a 529 plan as of December 2005, each individual's 529 investments in federally-insured products would be aggregated with their other accounts (e.g., checking, savings and time deposits) at the same underlying banking institution to determine the applicable insurance limit. "Traceability" is the key to aggregating accounts for FDIC purposes.

With typical bank accounts, the FDIC easily can trace its financial exposure to any single bank customer. The challenge for 529 Plans, however, has been the complexity of 529 recordkeeping, which is typically handled by the Plan's Program Manager (or directly by the five States that manage proprietary recordkeeping systems). Recognizing this, the FDIC's 2005 rule change established the following criteria for traceability:

- Disclosure of the trust relationship in accordance with FDIC requirements for fiduciary accounts (e.g., an account must be titled to show the name of the trust and the records for the account must disclose the identity of the participants), and
- The funds in the account are traceable to one or more particular investors or participants

Applying these criteria in the 529 market has been relatively easy. From a disclosure standpoint, "CollegeCounts Program Trust for the Benefit of CollegeCounts Savings Plan Participants" would be sufficient for the fiduciary account at the bank level. Over the last several years, the tracing requirement has evolved with an omnibus bank account at the financial institution tied to individual participant records *at the 529 plan level*. This requires careful accounting for all deposits to 529 accounts at the 529 plan level, with the aggregate amount invested in the insured savings vehicle equal to the sum of the individual investments.

On the legislative front, the US House of Representatives passed the "Deposit Restricted Qualified Tuition Programs Act" in April 2010 ("HR 4178"), which essentially allowed for Section 529 deposits to multiple insured institutions. It also treated those deposits as "identified banking products", which are exempt from the definition of a "security" under the Securities Act of 1933, the Securities and Exchange Act of 1934, and the Investment Company Act of 1940. The legislation was originally introduced by Congressman Emanuel Cleaver (D-Missouri), with Senator Claire McCaskill (D-Missouri) introducing similar language in an amendment to the bill that would eventually become the Dodd Frank Act ("SA 3846"). While HR 4178 passed the House on a voice vote, SA 3846 did not become part of Dodd Frank.

By way of background, we note that the legislative actions by Congressman Cleaver and Senator McCaskill were undertaken on behalf of the Missouri Bankers Association, which previously sought a "no-action" determination from the Securities and Exchange Commission on the nature of a bank deposit 529 plan.⁴ The

⁴ This stems back to 2004 Missouri legislation that authorized a "higher education deposit program" as a Missouri Section 529 plan offering investments in bank-insured certificates of deposit. The Missouri State Treasurer's Office sought a deposit program administrator, but we believe its efforts were stymied by the recordkeeping and regulatory challenges of offering a "security" (interests in a 529 trust) across multiple banks.



Memorandum to CollegeCounts Board, July 30, 2012

no-action letter request would have allowed all Missouri banks to offer 529 plan interests – understood to be “securities” – without licensing of bank sales professionals. The SEC’s refusal to grant no-action relief from licensing requirements forced the Missouri Bankers Association to seek a federal legislative solution.

To date, Congress has not resurrected the concepts of HR 4178 or SA 3846 and so we are left with FDIC-insured investments characterized as municipal fund securities, which can only be offered by licensed professionals or by entities exempt from licensing, such as State employees or, presumably financial institutions such as the College Savings Bank (for the stand-alone CollegeSure 529 Plans in Arizona, Indiana and Montana). In all other cases, interests in 529 Plans that are invested in FDIC-insured instruments are sold as securities alongside other 529 investment options.

The next section of this memo provides a snapshot of the FDIC-insured options available across the 529 industry today.

III THE MARKET TODAY

The following charts show how 529 Plans offer bank products, whether in a stand-alone 529 Bank Plan or as an investment option within a broadly structured 529 Plan. As shown immediately below, the stand-alone 529 Bank Plan model was prevalent in the early years but the bank product as an investment option within a 529 Plan now dominates how these products are offered:

States Offering Stand-Alone 529 Bank Plans		
State / Plan	Program Manager	Launched
Arizona CollegeSure 529 Plan	College Savings Bank	1999
Colorado Smart Choice College Savings Plan	CollegeInvest / First Bank	2009
Indiana College Choice CD Savings Plan	College Savings Bank	2011
Montana CollegeSure 529 Plan	College Savings Bank	1998
Virginia CollegeWealth	Virginia College Savings Plan	2007

It is interesting to note in the chart above that three 529 Bank Plans are managed by the College Savings Bank (Arizona, Indiana and Montana) and the remaining two – Colorado’s *Smart Choice* and Virginia’s *CollegeWealth* – are managed by each State without the involvement of a private sector program manager. In these five cases, the recordkeeping is within the control of the “manager” whether it is the College Savings Bank or the States that operate proprietary recordkeeping systems. The College Savings Bank *CollegeSure Plans* in Arizona and Montana pre-date the 2005 FDIC rule change but the Colorado and Virginia Plans were launched in compliance with the FDIC’s disclosure and traceability requirements. More detailed information on the actual bank products is included in Table 1 of the Appendix to this memo.

States Offering Bank Products as Individual Investment Options		
State	Program Manager	Launched
Arizona	Fidelity	2010
Arkansas	Upromise	2011
Delaware	Fidelity	2010

States Offering Bank Products as Individual Investment Options		
State	Program Manager	Launched
Idaho	Upromise	2011
Indiana (Advisor and Direct)	Upromise	2010
Maine	Merrill Lynch	2012
Massachusetts	Fidelity	2010
Nebraska	First National Bank of Omaha	2011
Nevada	Upromise	2010
New Hampshire	Fidelity	2010
North Carolina	College Foundation	2010
Ohio	Ohio Tuition Trust Authority	2005
Utah	Utah Education Savings Plan	2009
Wisconsin	Wells Fargo	2008

The chart immediately above shows that in the fifteen Plans where bank products are offered as individual investment options, two Program Managers dominate the market: five Plans are managed by Upromise (with a Sallie Mae Bank savings account in Arkansas, Idaho, Indiana Direct and Advisor, and Nevada) and four Plans are managed by Fidelity (with a Wells Fargo Bank savings account in Arizona, Delaware, Massachusetts and New Hampshire). Three Plans are managed directly by States (North Carolina, Ohio and Utah), and the remaining three Plans are “one-offs” in terms of the Program Managers and associated financial institutions (Maine, Nebraska, and Wisconsin). Table 2 in the Appendix to this memo provides additional information about these investment options.

IV OBSERVATIONS ON WAYS 529 MODELS

STAND-ALONE 529 BANK PLANS. The stand-alone 529 bank plan seems like it should be easy to launch and implement. However, we see two key challenges to this model: first, the bank plan “program manager” has to create a recordkeeping system for the bank products, and second, the bank plan has to be aggregated with other 529 plans offered within the same state. We believe the complexity of 529 recordkeeping has suppressed interest in 529 program management at banking institutions. If the recordkeeping could be created, account aggregation would follow. We believe that the ability to control the recordkeeping is critical to successfully offering stand-alone 529 bank plans.

BANK PRODUCTS AS INDIVIDUAL INVESTMENT OPTIONS. The growth in 529 bank products has come in the last two years or so and it has come largely through Fidelity and Upromise as Program Managers. Offering the bank products as investments within existing 529 Plans allows each Program Manager to treat these options like any other investment option. The underlying investment is an omnibus account at an insured institution rather than a mutual fund. This structure does not change the nature of the investment – it is still a municipal fund security – and thus it cannot be offered within brick and mortar bank branches unless the bank personnel are licensed to distribute securities. Interestingly, in each of the Plans that offer these insured investment options, the underlying financial institutions either have no in-State presence (e.g., Sallie Mae Bank) or the bank branches provide marketing materials but no enrollment, deposit or withdrawal functions (e.g., Fifth Third in Ohio and Zions Bank in Utah).



MULTIPLE BANK OPTIONS. To date, no 529 Plan offers an individual investor an insured investment option based upon multiple underlying banks. In the past, Missouri and Wisconsin each tried to design plans or savings options that would include multiple banks, but neither State was successful. A multi-bank product in Missouri never went beyond the conceptual stage, with the Missouri Bankers Association ultimately failing to receive a no-action letter from the SEC (see footnotes 3 and 4 above). And in Wisconsin, the State launched a bank product with multiple Wisconsin banks (and, initially, Wisconsin credit unions) but the per-participant benefit of FDIC insurance *does not extend to individual account owners*. Thus, although we include the Wisconsin bank investment option within the “individual investment option” category in Section III above, the \$250,000 FDIC insurance is limited to the Wisconsin trust because the Plan cannot trace insured funds to particular participants.

V CONSIDERATIONS

Market volatility has been a big impetus for offering insured bank products in 529 plans, and this remains the case in the aftermath of financial market performance from the fourth quarter of 2007 through the first quarter of 2009. The insured bank product appeals to three kinds of investors: (i) extremely risk-averse investors generally, (ii) investors who expect to withdraw funds in the near-term for college expenditures, and (iii) investors who seek safety while deciding where to invest for the longer term (including, for example, investors who make time-sensitive contributions for tax purposes). We estimate that the industry has accumulated approximately \$750 million in bank product assets. In our view, this demonstrates that college savers remain interested in investments that present no risk of loss, particularly as the time for college payments approaches.

As this memo demonstrates, the number of plans offering federally-insured 529 investment options has increased substantially since December 2005, with the majority of new options launched as individual investment options in the last two years. This suggests that 529 Plans are becoming more comfortable and compliant with the regulatory conditions established by the FDIC for per-participant insurance coverage. That being said, we are cognizant of the fact that the 529 Plans now offering federally-insured products among other investment options represent a very small part of the industry:

- Uppromise offers a Sallie Mae Bank product in five Plans
- Fidelity offers a Wells Fargo Bank product in four Plans
- Merrill and First National Bank of Omaha (“FNBO”) each offer a single bank product through proprietary banking relationships with Bank of America and FNBO, respectively
- North Carolina, Ohio and Utah each operate proprietary recordkeeping systems and thus are able to trace investments in omnibus bank accounts

From the perspective of Union Bank, we believe the easiest implementation of a bank product would be as an individual investment option. Assuming Union Bank agrees, the next issue will be to determine the entity through which the insured products will be offered, that is, whether Union Bank or an Alabama-based financial institution provides the underlying savings vehicle. We note that should CollegeCounts seek a financial institution other than Union Bank to provide the underlying savings vehicle, there may be pricing consequences that could defeat one of the implicit benefits of a bank product – to provide a *low-cost*, risk-free investment option.



Memorandum to CollegeCounts Board, July 30, 2012

On a more practical level, it should be clear to the CollegeCounts Board that sufficient demand exists within Alabama for a federally-insured product in lieu of some other short term or guaranteed option. Union Bank will have to incur costs for this project so there should be some expectation on timing to recoup any upfront costs. It seems to us that proponents of a federally-insured option should demonstrate investor demand before the Board moves ahead.

From a product perspective, we believe that the challenges of the past are diminishing as long as the recordkeeping can be handled efficiently. Some of the issues that remain, however, include:

- Creating multiple distribution points across the State (e.g., the benefit of brick-and-mortar locations for Alabama investors)
- Offering a federally-insured product in a way that will not violate the Securities laws
- To the extent any banking association or consortium is involved, creating an option that allows for participation by multiple banking entities (e.g., ensuring deposit traceability and disclosure on participating institutions so that investors can assess their own exposure to insurance limits)

We hope this brief summary has provided a useful overview on 529 bank products. We will welcome the opportunity to discuss in greater detail the potential for a federally-insured CollegeCounts option.



Memorandum to CollegeCounts Board, July 30, 2012

APPENDIX

TABLE 1: BANK PRODUCTS IN STAND-ALONG 529 BANK PLANS

State	Plan Name	Bank Provider	Investment Option Name	Description	Year Launched	Current Yield (7/27/2012)
AZ	CollegeSure 529 Plan	College Savings Bank	CollegeSure CD	Certificate of deposit ("CD") account using variable interest rates pegged to a private-college tuition index	1999	3.46% (< 3 Yr APY) 3.81% (3-5 Yr APY) 4.41% (> 5 Yr APY)
		ditto	InvestorSure CD	Equity-indexed CD account that pegs interest rate to a percentage of increase in the S&P 500 Index over a 5-year period to benefit from market highs without risking principal	1999	1.65% (5 Yr APY) 1.22% (10 Yr APY) 3.55% (20 Yr APY)
		ditto	Fixed-Rate CD	Tax advantaged CD accounts with 1-year or 3-year fixed maturities	5/2009	0.55% (1 Yr APY) 0.90% (3 Yr APY)
		ditto	Honors Savings Account	Tax advantaged high-yield savings account with minimal required fees	1/2012	0.60%
CO	Smart Choice College Savings Plan	First Bank	1-Year Time Savings Account	Account earns interest at a rate that is 0.10% < the rate publicly offered by FirstBank for its regular 1-Year Times Savings Accounts, subject to an early withdrawal penalty of 90 days of interest if withdrawn before the 1-year maturity date.	2009	0.20% (1 Yr APY)
		ditto	Money Market Savings Account	Account earns interest at a rate established by FirstBank not less than the interest rate publicly offered by FirstBank on its regular Money Market Savings Accounts less 0.10%.	2009	0.20% for \$0-\$20K 0.40% for \$100K and above (1 Yr APY)
IN	CollegeChoice CD Savings Plan	College Savings Bank	CollegeSure CD	See Arizona above	4/1/2011	3.46% (< 3 Yr APY) 3.81% (3-5 Yr APY) 4.41% (> 5 Yr APY)
		ditto	InvestorSure CD	See Arizona above	4/1/2011	1.65% (5 Yr APY) 1.22% (10 Yr APY) 3.55% (20 Yr APY)
		ditto	Fixed-Rate CD	See Arizona above	4/1/2011	0.55% (1 Yr APY) 0.90% (3 Yr APY)
		ditto	Honors Savings Account	See Arizona above	1/1/2012	0.60%
MT	CollegeSure 529 Plan	College Savings Bank	CollegeSure CD	See Arizona above	1998	3.46% (< 3 Yr APY) 3.81% (3-5 Yr APY) 4.41% (> 5 Yr APY)
		ditto	InvestorSure CD	See Arizona above	1998	1.65% (5 Yr APY) 1.22% (10 Yr APY) 3.55% (20 Yr APY)
		ditto	Fixed-Rate CD	See Arizona above	10/2009	0.55% (1 Yr APY) 0.90% (3 Yr APY)
		ditto	Honors Savings Account	See Arizona above	1/1/2012	0.60%
VA	CollegeWealth	BB&T	BB&T CollegeWealth 529 Savings	Bank deposit accounts	2007	2.00% for < \$25K 2.25% for ≥ \$25K
		Union Bank	Union First Market Bank CollegeWealth Savings	Bank deposit accounts	2007	CD rates: 0.60% (13 month) 0.85% (27 month) Money Market rates: 0.15-0.40% depending on tier College Wealth 529: 2.00% for <\$10K 2.30% for ≥\$10K
5 States	5 Plans		15 Options			



APPENDIX

TABLE 2: BANK PRODUCTS OFFERED AS INDIVIDUAL INVESTMENT OPTIONS IN 529 PLANS

State	Plan Name	Bank Provider	Investment Option Name	Description	Year Launched	Current Yield (7/27/2012)
AZ	Fidelity College Savings	Wells Fargo	Bank Deposit Portfolio	Negotiable Order Withdrawal (NOW) Account	9/28/2010	0.01%
AR	iShares	Sallie Mae	Savings Portfolio	High-yield savings account held in an omnibus savings account in trust for the Plan at Sallie Mae Bank	7/28/2011	0.50%
DE	College Investment Plan	Wells Fargo	Bank Deposit Portfolio	See Arizona above (Fidelity College Savings)	9/28/2010	0.01%
ID	IDeal	Sallie Mae	Savings Portfolio	See Arkansas above (College Investment Plan)	11/30/2011	0.51%
IN	CollegeChoice (Direct)	Sallie Mae	Savings Portfolio	See Arkansas above (College Investment Plan)	7/19/2010	0.56%
	CollegeChoice (Advisor)	Sallie Mae	Savings Portfolio	See Arkansas above (College Investment Plan)	7/19/2010	0.50%
ME	NextGen College Savings Plan	Bank of America, NA	Savings Portfolio	Omnibus bank deposit account	1/23/2012	0.21%
MA	U.Fund College Investing	Wells Fargo	Bank Deposit Portfolio	See Arizona above (Fidelity College Savings)	9/28/2010	0.01%
NE	Nebraska Educational Savings Trust - Direct	First National Bank of Omaha	Bank Savings Option	Omnibus savings account	10/17/2011	0.50%
NV	SSgA Uprromise 529	Sallie Mae	High-Yield Savings Account	See Arkansas above (College Investment Plan)	10/18/2010	0.56%
NH	UNIQUE College Investing	Wells Fargo	Bank Deposit Portfolio	See Arizona above (Fidelity College Savings)	9/28/2010	0.01%
NC	National College Savings Plan	State Employees Credit Union	Federally-Insured Deposit Account	SECU sets rate; interest is compounded daily and credited monthly.	2010	1.51%
OH	CollegeAdvantage Savings Plan	Fifth Third	Fifth Third 529 CD	Bank deposit account with flexible maturity dates (3 months to 12 years)	10/1/2005	0.50% (1-2 Yr APY) 0.75% (2-3 Yr APY)
		Fifth Third	Fifth Third 529 Savings Account	Bank deposit accounts	10/1/2005	0.15-0.65% APY
UT	UESP Trust	Zions Bank	FDIC-Insured Savings Account	Omnibus savings account held in trust for UESP	2/11/2009	0.64%
WI	Edvest Direct Sold	Consortium of WI Banks	Fixed-Rate CD	Certificates of deposit issued by Wisconsin-based banks. The Trust has FDIC insurance; the investor does not.	10/1/2008	0.04% (1 month SEC-yield)
14 States	15 Plans		16 Options			